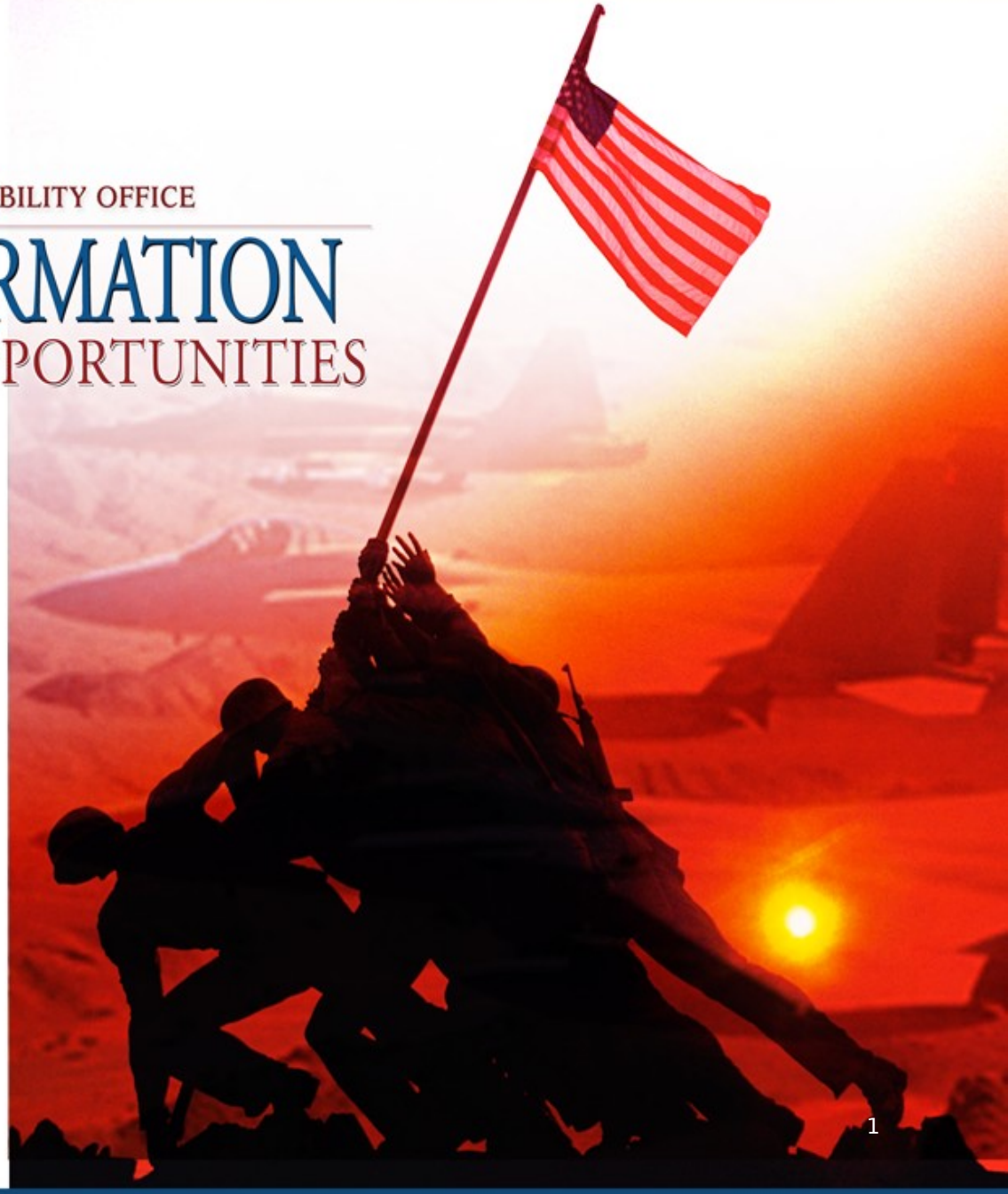
UNITED STATES GOVERNMENT ACCOUNTABILITY OFFICE

DOD TRANSFORMATION
CHALLENGES AND OPPORTUNITIES



The Honorable David M. Walker
Comptroller General of the United States

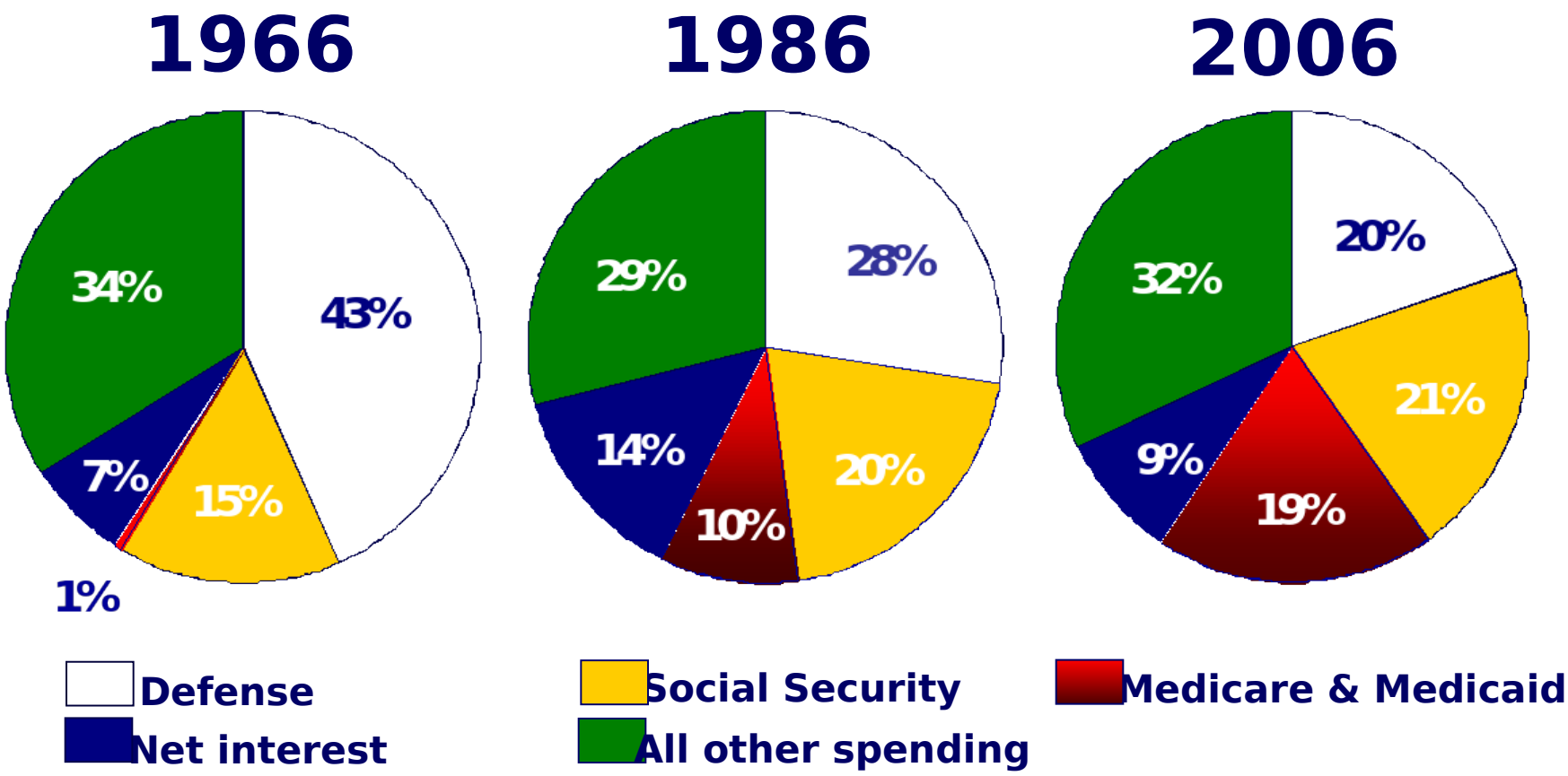
Acquisition Community Conference
Defense Acquisition University
Fort Belvoir, VA
April 17, 2007

The Case for Change

The federal government is on a "burning platform," and the status quo way of doing business is unacceptable for a variety of reasons, including:

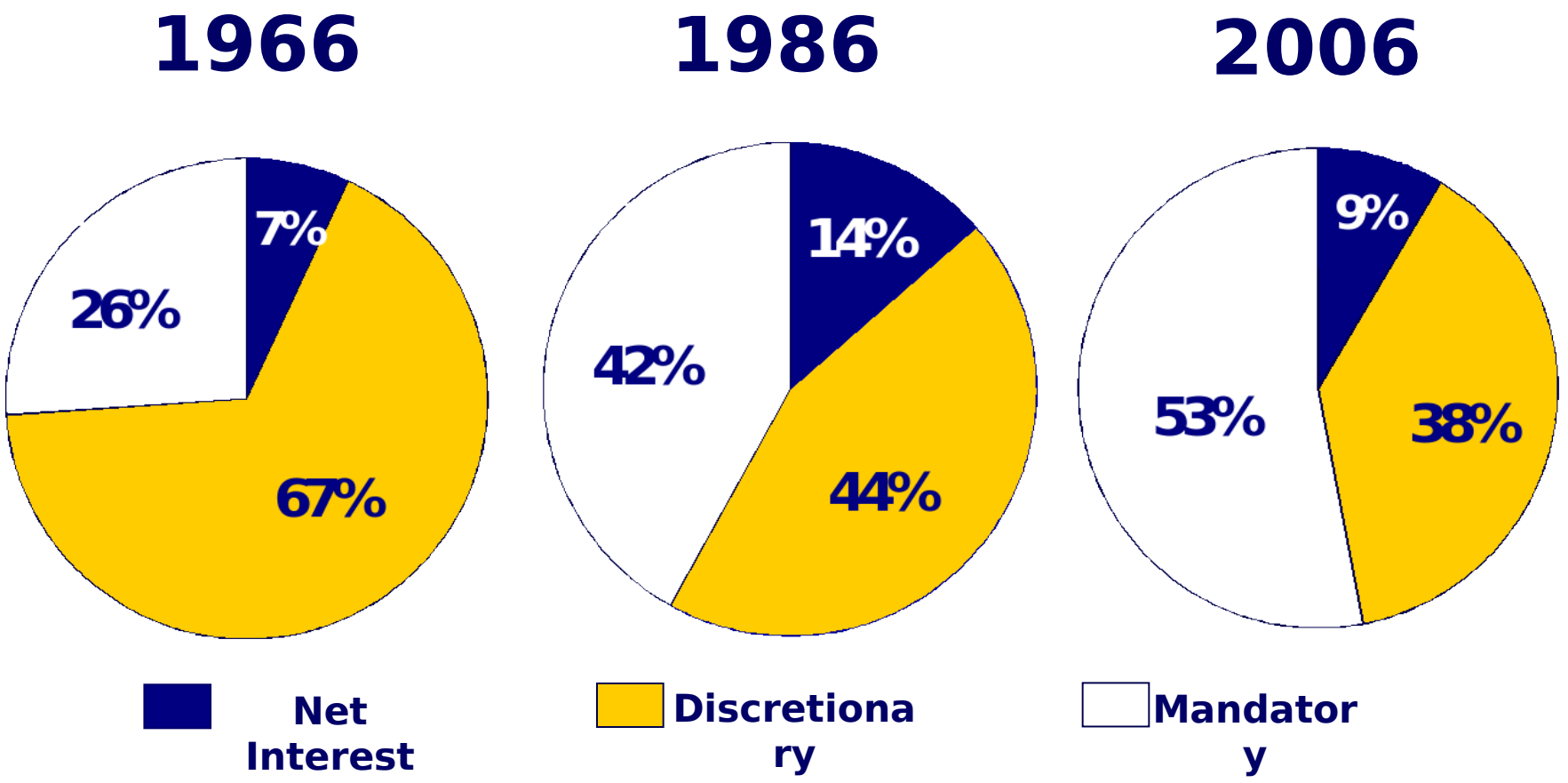
- Past fiscal trends and significant long-range challenges
- Selected trends and challenges having no boundaries
- Additional resource demands due to Iraq, Afghanistan, incremental homeland security needs, and recent natural disasters in the United States
- Numerous government performance/accountability and high risk challenges
- Outdated federal organizational structures, policies, and practices
- Rising public expectations for demonstrable results and enhanced responsiveness

Composition of Federal Spending



Source: Office of Management and Budget.
Note: Numbers may not add to 100 percent due to rounding.

Federal Spending for Mandatory and Discretionary Programs



Source: Office of Management and Budget.

Current Fiscal Policy Is Unsustainable

- **The "Status Quo" Is Not an Option**
  - We face large and growing structural deficits largely due to known demographic trends and rising health care costs
  - GAO's simulations show that balancing the budget in 2040 could require actions as large as
    - Cutting total federal spending by 60 percent or
    - Raising federal taxes to two times today's level
- **Faster Economic Growth Can Help, but It Cannot Solve the Problem**
  - Closing the current long-term fiscal gap based on reasonable assumptions would require real average annual economic growth in the double-digit range every year for the next 75 years
  - During the 1990s, the economy grew at an average 3.2 percent per year
  - As a result, we cannot simply grow our way out of this problem. Tough choices will be required

The Way Forward:
A Three-Pronged Approach

1. Improve Financial Reporting, Public Education, and Performance Metrics

2. Strengthen Budget and Legislative Processes and Controls

3. Fundamentally Reexamine and Transform for the 21st Century (i.e., entitlement programs, other spending, and tax policy)

Solutions Require Active Involvement from

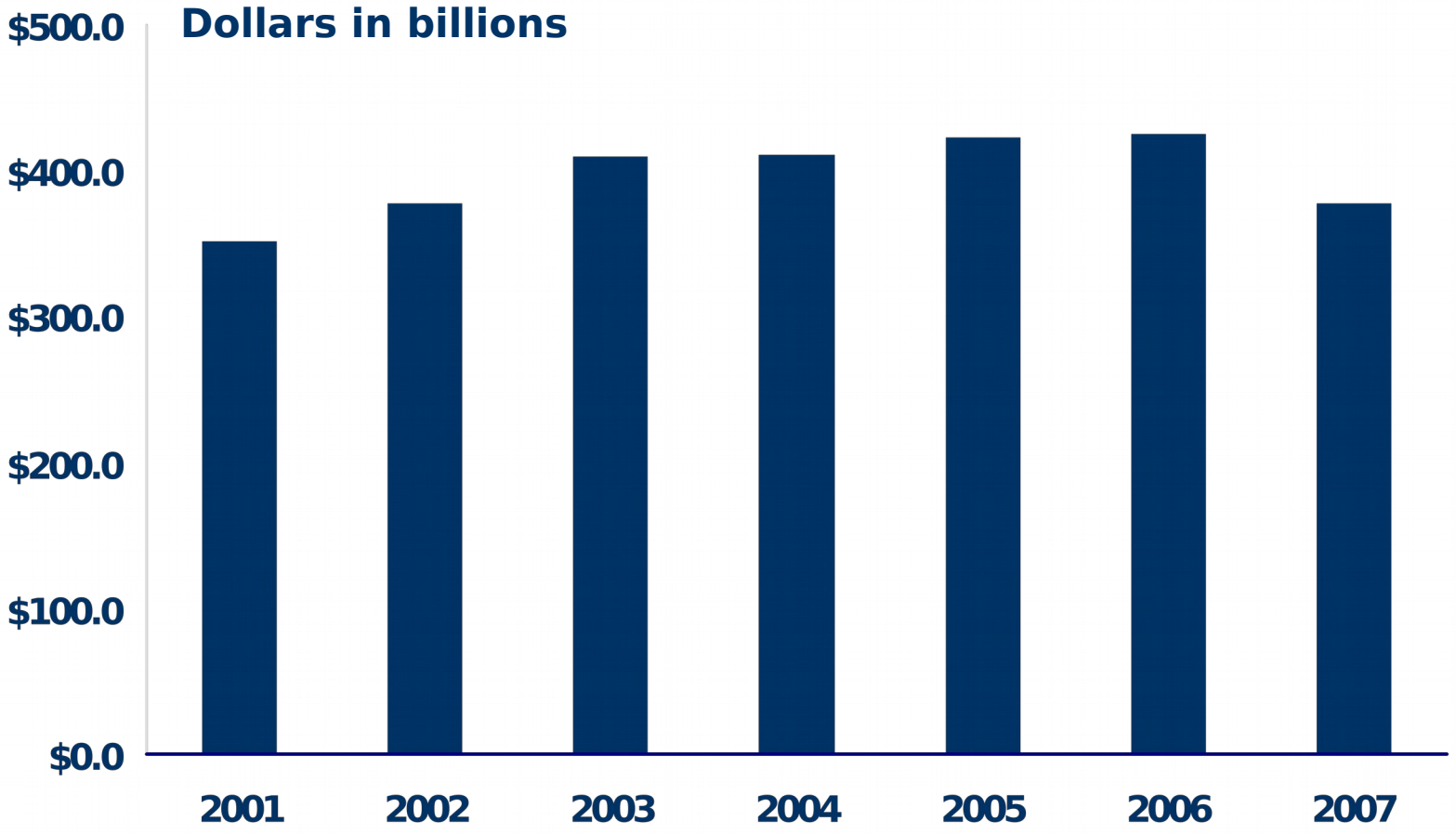
both the Executive and Legislative Branches

DOD Faces the Challenge of Balancing Near Term and Long Term Wants, Needs, and Affordability

- In FY 2007 constant dollars, DOD's regular budget has grown from about $351 billion in FY 2001 to about $425 billion in FY 2006. To date, DOD's FY 2007 regular budget is funded at about $378 billion, with decisions on additional funding for military construction and other programs still pending. Supplemental funding for the Global War on Terrorism (GWOT) has added hundreds of billions of dollars to DOD's available budgetary resources
- Near term, DOD is paying for the GWOT and facing challenges in maintaining readiness
- Long term, DOD must address military pay and benefits and weapons modernization and force transformation, which may not be affordable or sustainable
- DOD's efforts to transform its business systems and processes will take many years to achieve, but could free up resources through efficiencies and reduction in waste

DOD's Regular Budget Growth (Excluding GWOT)

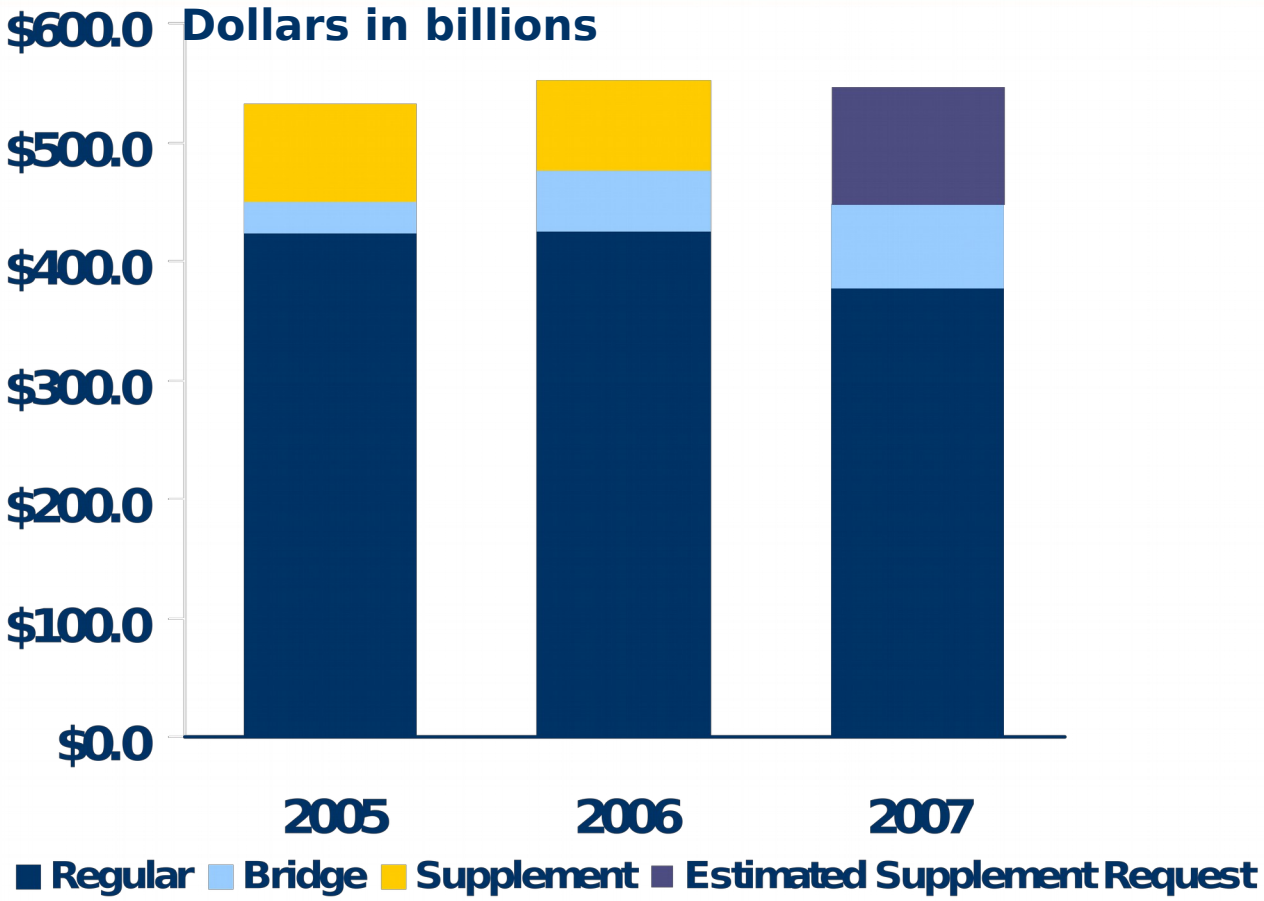
DOD Regular Appropriation FY 2001-2007



Source: GAO analysis of Congressional Research Service data.
Note: The FY 2007 figure does not include funding for military construction and other programs, which is being considered in a single appropriations bill that has not yet been passed. All amounts are in constant 2007 dollars.

Total Budgetary Resources Provided to DOD

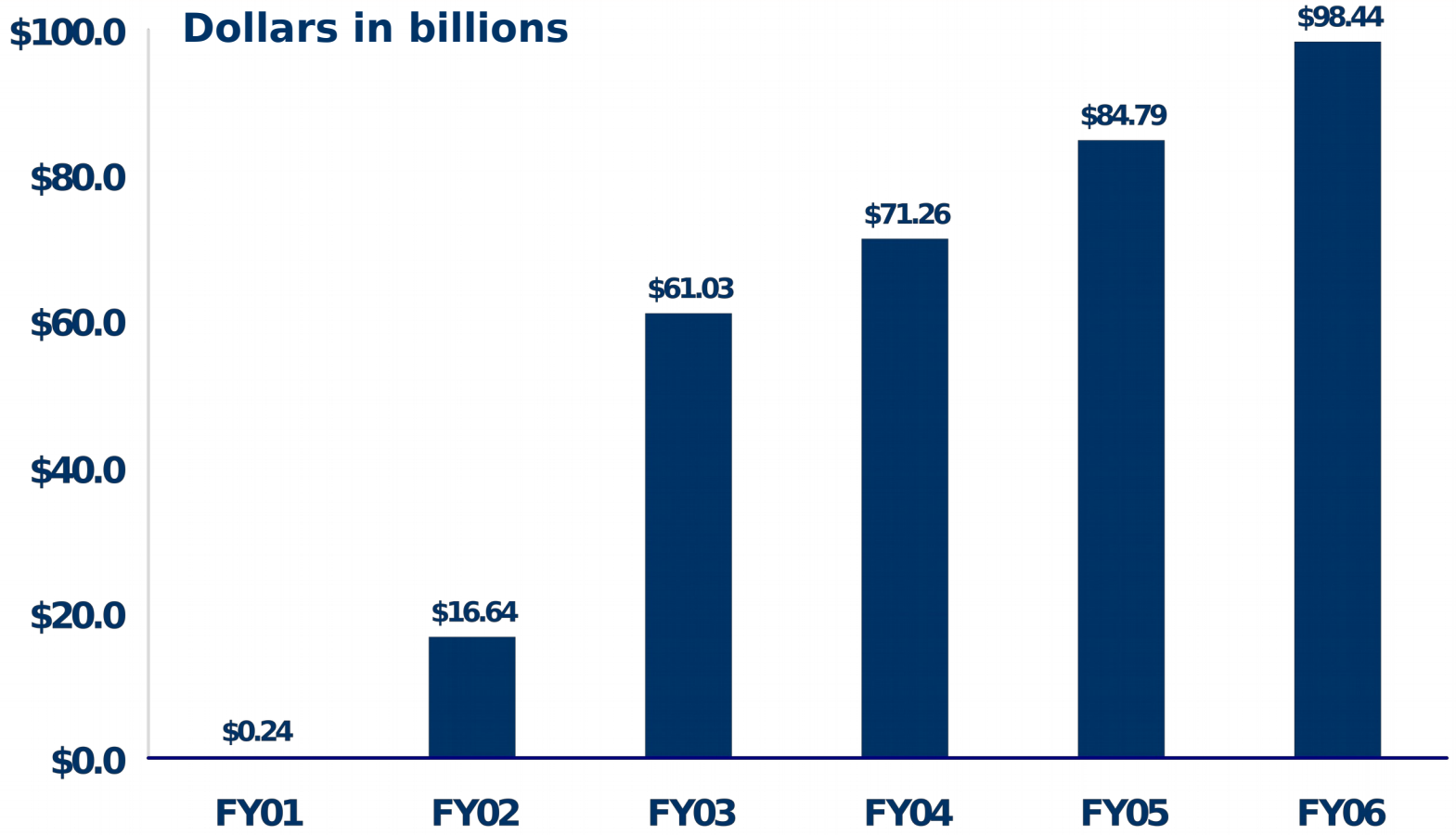
Total Defense Resources FY 2005-2007 (as of January 2007)



Source: GAO analysis of Congressional Research Service data.

Notes: Bridge, or Title IX, is the section of DOD's regular defense appropriation that outlines emergency spending provisions for operations in support of GWOT. The figure shown for the FY 2007 regular appropriation does not include funding for military construction and other programs, which is being considered in a single appropriations bill that has not yet been passed. DOD's FY 2007 supplemental request, not yet submitted, has been estimated at about $100 billion. All amounts are in constant 2007 dollars.

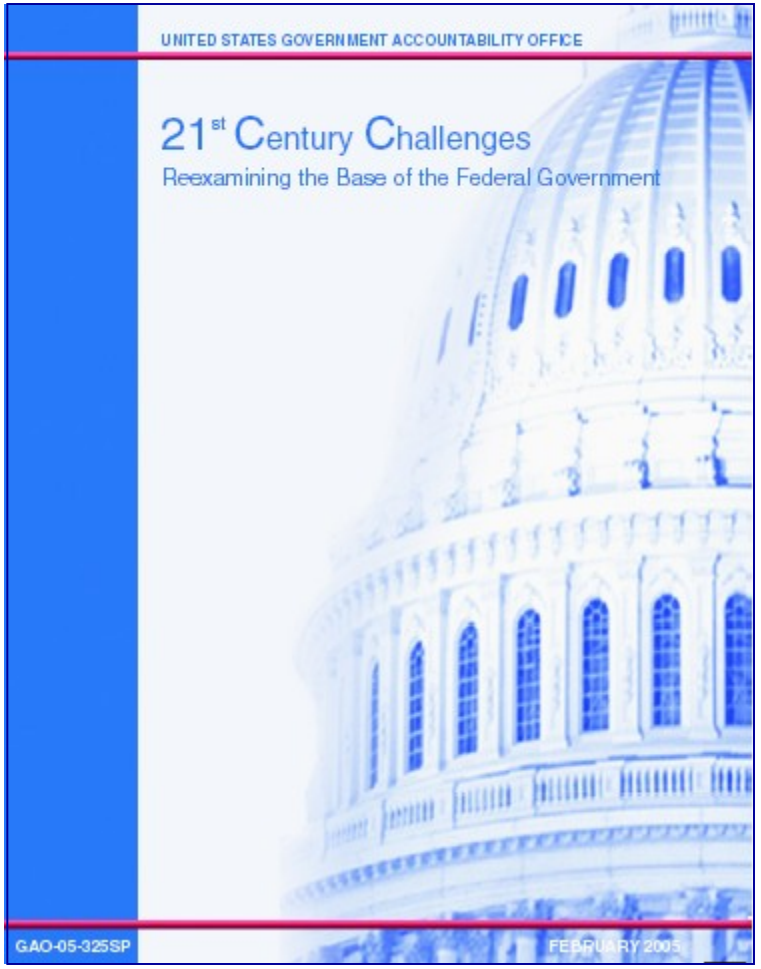
DOD's Reported GWOT Obligations for FY 2001 thru FY 2006



Source: GAO analysis of DOD data.
Note: Reported GWOT obligations include Operation Noble Eagle, Operation Enduring Freedom, and Operation Iraqi Freedom. Figures do not include about $17.9 billion obligated in FY 2001-2003 that DOD did not include in its cost reports, or any obligations for classified activities. GAO has assessed the reliability of DOD's obligation data and found significant problems, such that they may not accurately reflect the true dollar value of GWOT obligations.

21st Century Challenges Report

- Provides background, framework, and questions to assist in reexamining the base
- Covers entitlements & other mandatory spending, discretionary spending, and tax policies and programs
- Based on GAO's work for the Congress
- Issued February 16, 2005



Source: GAO.

Twelve Reexamination Areas

MISSION AREAS

- Defense
- Education & Employment
- Financial Regulation & Housing
- Health Care
- Homeland Security
- International Affairs
- Natural Resources, Energy & Environment
- Retirement & Disability
- Science & Technology
- Transportation

CROSSCUTTING AREAS

- Improving Governance
- Reexamining the Tax System

Illustrative 21st Century Questions:
National Defense

- How should the historical allocation of resources across services and programs be changed to reflect the results of a forward-looking comprehensive threat/risk assessment as part of DOD's capabilities-based approach to determining defense needs?

- Can DOD afford to invest in transformational systems such as the Future Combat System and national missile defense at the same time it continues to pursue large investments in legacy systems such as the F-22A and new systems like the Joint Strike Fighter, especially if cost growth and schedule delays continue at historical rates?

- Given the global availability of rapidly advancing technology, does DOD need to reconsider its approach for identifying critical technologies and protecting those technologies from being exploited in order to maintain its military superiority?

Illustrative 21st Century Questions:
National Defense (cont'd)

- Given the growing encumbrance of pay and benefit costs, especially health care, within DOD's budget, how might DOD's recruitment, retention, and compensation strategies (including benefit programs) be reexamined and revised to ensure that DOD maintains a total military and civilian workforce with the mix of skills needed to execute the national security strategy while using resources in a more targeted, evidence-based, and cost-effective manner?
- Do the role, size, and structure of forces and capabilities comprising the strategic triad need to be adjusted to meet the challenges of providing strategic deterrence in the new security and fiscal environment?
- Does DOD need to create a senior management position responsible and accountable for taking a strategic, integrated, and sustained approach to managing the day-to-day business operations of the department, including ongoing efforts to transform DOD's business operations and address the many related and longstanding high-risk areas? Should specific qualifications requirements and periods of tenure or terms be established for selected DOD positions related to key business operations?

GAO's High-Risk List 2007

Addressing Challenges in Broad-based Transformations	Year Designated
•Strategic Human Capital Management[a]	2001
• Managing Federal Real Property[a]	2003
• Protecting the Federal Government's Information Systems and the Nations' Critical Infrastructures	1997
•Implementing and Transforming the Department of Homeland Security	2003
• Establishing Appropriate and Effective Information-Sharing Mechanisms to Improve Homeland Security	2005
• **DOD Approach to Business Transformation[a]**	**2005**
•**DOD Business Systems Modernization**	**1995**
•**DOD Personnel Security Clearance Program**	**2005**
•**DOD Support Infrastructure Management**	**1997**
•**DOD Financial Management**	**1995**
•**DOD Supply Chain Management**	**1990**
•**DOD Weapon Systems Acquisition**	**1990**
• FAA Air Traffic Control Modernization	**1995**
• Financing the Nation's Transportation System[a] **(New)**	2007
• Ensuring the Effective Protection of Technologies Critical to U.S. National Security Interests[a] **(New)**	2007
• Transforming Federal Oversight of Food Safety[a] **(New)**	2007
Managing Federal Contracting More Effectively	
•**DOD Contract Management**	**1992**
•DOE Contract Management	1990
•NASA Contract Management	1990
•Management of Interagency Contracting	2005
Assessing the Efficiency and Effectiveness of Tax Law Administration	
•Enforcement of Tax Laws[a]	1990
•IRS Business Systems Modernization	1995
Modernizing and Safeguarding Insurance and Benefit Programs	
•Modernizing Federal Disability Programs[a]	2003
•Pension Benefit Guaranty Corporation Single-Employer Pension Insurance Program	2003
•Medicare Program[a]	1990
•Medicaid Program[a]	2003
•National Flood Insurance Program[a]	2006

Source: GAO.

[a] Legislation is likely to be necessary, as a supplement to actions by the executive branch, in order to effectively address this high-risk area.

Key Oversight Areas for the 110th Congress

Examples of targets for near-term oversight:

- Addressing governmentwide acquisition and contracting issues
- Transforming the business operations of the Departments of Defense

Examples of policies and programs that are in need of fundamental reform and re-engineering:

- Reviewing U.S. and coalition efforts to stabilize and rebuild Iraq and Afghanistan
- Ensuring a strategic and integrated approach to prepare for, respond to, recover, and rebuild from catastrophic events

Examples of governance issues that should be addressed to help ensure an economical, efficient, ethical, and equitable federal government capable of responding to the various challenges and capitalizing on related opportunities in the 21st century:

- Reviewing the need for various budget controls and legislative process revisions in light of current deficits and our long-range fiscal imbalance
- Reviewing the impact and effectiveness of various management reforms

Suggested DOD Related Oversight Areas for the 110th Congress

- Address acquisition and contracting issues
- Transform business operations, including addressing all related "High Risk" areas
- Enhance information sharing, accelerate transformation, and improve oversight related to the Nation's intelligence agencies
- Strengthen efforts to prevent proliferation of nuclear, chemical, and biological weapons and their delivery systems (missiles)
- Ensure a successful transformation of the nuclear weapons complex
- Review U.S. and Coalition efforts to stabilize and rebuild Iraq and Afghanistan, including how these efforts are to be funded
- Assess overall military readiness, transformation efforts, and existing plans to assure the sustainability of the All-Volunteer Force

Note: From November 17, 2006 letter to the 110th Congress (GAO-07-235R)

Trans FORMATION

Webster's definition

An act, process, or instance of change in structure appearance, or character

A conversion, revolution, makeover, alteration, or renovation

GAO
Accountability * Integrity * Reliability

The Objective of Transformation for DOD

Creating the future of warfare and protecting our national security while improving how the department, including all of its various component parts, does business in order to support and sustain our position as the world's preeminent military power within current and expected resource limits

Definition of Waste

Waste involves the taxpayers as a whole not receiving reasonable value for money in connection with any government funded activities due to an inappropriate act or omission by players with control over or access to government resources (e.g., executive, judicial, or legislative branch employees, contractors, grantees, or other recipients)

Importantly, waste represents a transgression that is less than fraud and abuse and most waste does not involve a violation of law. Rather, waste relates primarily to mismanagement, inappropriate actions, or inadequate oversight

Examples of Waste

Illustrative examples of underlying causes of waste in the acquisitions and contracting area could include:

- Unreasonable, unrealistic, inadequate, or frequently changing requirements
- Failure to use competitive bidding in appropriate circumstances
- Failure to engage in selected pre-contracting activities for contingent events (e.g., hurricanes, military conflicts)
- Congressional directions (e.g., earmarks), and agency spending actions where the action would not otherwise be taken based on an objective value and risk assessment and considering available resources

Systemic Defense Acquisition Challenges

1. **Service budgets are allocated largely according to top line historical percentages rather than Defense-wide strategic assessments and current and likely resource limitations**

2. **Capabilities and requirements are based primarily on individual service wants versus collective Defense needs** (i.e. based on current and expected future threats) that are both affordable and sustainable over time

3. **Defense consistently over-promises and under-delivers in connection with major weapons, information, and other systems** (i.e. capabilities, costs, quantities, schedule)

4. **Defense often employs a "plug and pray approach" when costs escalate** (i.e. divide total funding dollars by cost per copy, plug the number that can be purchased, then pray that Congress will provide more funding to buy more quantities)

5. **Congress sometimes forces the department to buy items** (e.g. weapons systems) **and provide services** (e.g. additional health care for non-actives) **that the department does not want and we cannot afford**

Systemic Defense Acquisition Challenges (cont'd)

6. **DOD tries to develop high risk technologies after programs start instead of setting up funding, organizations, and processes to conduct high risk technology development activities in low cost environments** (i.e. technology development is not separated from product development). **Program decisions to move into design and production are made without adequate standards or knowledge**

7. **Program requirements are often set at unrealistic levels, then changed frequently as recognition sets in that they cannot be achieved.** As a result, too much time passes, threats may change, and/or members of the user and acquisition communities may simply change their mind. The resulting program instability causes cost escalation, schedule delays, fewer quantities and reduced contractor accountability

8. **Contracts, especially service contracts, often do not have definitive or realistic requirements at the outset in order to control costs and facilitate accountability**

9. **Contracts typically do not accurately reflect the complexity of projects nor appropriately allocate risk between the contractors and the taxpayers** (e.g. cost plus, cancellation charges)

Systemic Defense Acquisition Challenges (cont'd)

10. **Key program staff rotate too frequently thus promoting myopia and reducing accountability** (i.e. tours based on time versus key milestones). **Additionally, the revolving door between industry and the Department presents potential conflicts of interest**

11. **The acquisition workforce faces serious challenges** (e.g. size, skills, knowledge, succession planning)

12. **Incentive and award fees are often paid based on contractor attitudes and efforts versus positive results** (i.e. cost, quality, schedule)

13. **Inadequate oversight is being conducted by both the Defense Department and the Congress which results in little to no accountability for recurring and systemic problems**

14. **Some individual program and funding decisions made within the Department and by the Congress serve to undercut sound policies**

15. **Lack of a professional, term-based CMO at DOD serves to slow progress on defense transformation and reduce the chance of success in the acquisitions/contracting and other key business areas**

DOD Increasingly Relies on Contractors for Mission-Critical Services

- DOD's obligations on service contracts rose from $82.3 billion in fiscal year 1996 to $141.2 billion in fiscal year 2005
- According to DOD officials, the amount obligated on service contracts exceeded the amount the department spent on major weapon systems
- Growth in services coincided with decreases in DOD's workforce
- To a large extent, the growth in services was not a managed outcome

Growth in Services Poses Challenges to the Acquisition Workforce

- DOD carried out this downsizing without ensuring it had the specific skills and competencies needed to accomplish DOD's mission
- The amount, nature, and complexity of contracting for services have increased, challenging DOD's ability to
  - maintain a workforce with the requisite knowledge of market conditions and industry trends,
  - the ability to prepare clear statements of work, the technical details about the services they procure, and
  - the capacity to manage and oversee contractors

DOD Contract Management Challenges

- DOD continues to experience poor acquisition outcomes and missed opportunities to improve its approach to buying goods and services. For example, DOD did not
  - employ a strategic approach to acquiring services that enabled it to determine whether investments were achieving desired outcomes
  - always make sound use of various techniques to acquire goods and services (i.e. award and incentive fees, competitive acquisition approaches)
  - have a comprehensive plan to ensure its workforce had the right skills and capabilities to manage and assess contractor performance

Effective Management of Services Requires Both Strategic and Transactional Efforts

Strategic level

Effective service acquisition requires the leadership, processes, and information necessary for mitigating risks, leveraging buying power, and managing outcomes

Transactional level

Individual service transactions must focus on buying the right thing, the right way, while getting the desired outcomes

Source: GAO (analysis)

A comprehensive approach would use the strategic and transactional factors in a complementary manner to tailor management activity to ensure preferred outcomes

Examples of Shortcomings of DOD's Service Acquisition Approach

- Lacked a strategic plan to gauge whether ongoing and planned efforts were achieving intended results
- Lacked reliable information on the volume and composition of service acquisitions
- Management and review structure provided only limited insight:
  - DOD was unable to determine which or how many transactions had been reviewed
  - Military departments had reviewed proposed acquisitions accounting for less than 3 percent of service obligations in fiscal year 2005
  - No post-award assessments
- Focused on awarding contracts, with less attention paid to developing requirements and assessing contractor performance
- Individual acquisitions generally not used to inform strategic direction

Determining the Appropriate Role of Contractors in Meeting DOD's Needs

- Contractors have an important role to play in the discharge of the government's responsibilities, and in some cases the use of contractors can result in improved economy, efficiency, and effectiveness
- There may be occasions when contractors are used to provide certain services because the government lacks another viable and timely option. In such cases, the government may actually be paying more and incurring higher risk than if such services were provided by federal employees
- Examining the appropriate role for contractors is among the challenges in meeting the nation's defense and other needs in the 21st Century

Selected Potential DOD Transformation Related Actions

- Revise the current approach to developing national military strategy (e.g., order, integration)
- Take a longer range, and more enterprise-wide approach to program planning and budget integration (e.g., life cycles, opportunity costs)
- Employ a more strategic and integrated approach to business information system efforts and financial audit initiatives
- Differentiate between war fighting and business systems development, implementation, and maintenance (e.g., resource control, project approval)
- Focus on achieving real success in connection with financial management efforts (e.g., systems, controls, information, compliance and opinions)
- Employ a total force management approach to planning and execution (e.g., military, civilian, contractors)

Selected Potential DOD Transformation Related Actions (cont'd)

- Get the design and implementation of the NSPS right, including modernizing and integrating the DOD, Service, domain, unit, and individual performance measurement and reward systems
- Revise the process for developing and communicating key changes (e.g., DOD transformation, NSPS)
- Reduce the number of layers, silos, and footprints
- Recognize the difference between approving and informing
- Review and revise current military compensation policies and practices (e.g., more targeted and market-based)
- Strengthen emphasis on horizontal and external activities (e.g., partnerships)
- Create a Chief Management Officer (CMO) to drive the business transformation process

GAO's Recommendation for a CMO at DOD

- GAO has recommended that DOD establish a CMO to provide strong and sustained leadership over all major business transformation efforts. The CMO should:
  - Have a proven track record as a business process change agent in a large, complex, and diverse organization
  - Be a Deputy Secretary or Principal Under Secretary of Defense for Management
  - Serve a set term (e.g., 5 to 7 years) that spans administrations with potential for reappointment
  - Be a single point within the department with the perspective and responsibility, as well as authority, to develop an overall and integrated business transformation plan and help to ensure the effective implementation of related functional management and business transformation efforts

Key Leadership Attributes Needed for These Challenging and Changing Times

- ***Courage***
- ***Integrity***
- ***Creativity***
- ***Stewardship***
- ***Partnership***

On the Web

Web site: www.gao.gov/cghome.htm

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